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October 11, 2004

HAND DELIVERY

Mr. George N. Dorn, Jr.
Executive Director
Public Service Commission of South Carolina
Synergy Business Park, Saluda Building
101 Executive Center Drive
Columbia, SC 29210

Re: Calpine / SCE & G Rate Case
Docket No. 2004-178-E
Our File No. 03471-0002

Dear Mr. Dorn:

Enclosed for filing please find the Testimony of David Dismukes on behalf of Columbia Energy, LLC. Please date-stamp the extra copies of the testimony as proof of filing and return them with our courier.

If you have any questions, please have someone on your staff contact me.

Yours truly,

ROBINSON, MCFADDEN & MOORE, P.C.

Frank R. Ellerbe, III

FRE/mfc

Enclosures

cc/enc: Elliott Elam, Esquire
David E. Dismukes
Scott A. Elliott, Esquire
Douglas Turner, Esquire
Mr. Frank Knapp
Hanna Pokorna-Williamson, Esquire
Francis P. Mood, Esquire
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DIRECT TESTIMONY OF

DAVID E. DISMUKES

ON BEHALF OF

COLUMBIA ENERGY, LLC

DOCKET NO. 2004-178-E

I. INTRODUCTION

Q WOULD YOU PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

A My name is David E. Dismukes. My business address is 6455 Overton Street, Baton Rouge, Louisiana.

Q WOULD YOU PLEASE STATE YOUR OCCUPATION AND CURRENT PLACE OF EMPLOYMENT?

A I am a Consulting Economist with the Acadian Consulting Group ("ACG"), a research and consulting firm that specializes in the analysis of regulatory, economic, financial, accounting, and public policy issues associated with regulated and energy industries. ACG is a Louisiana-registered partnership, formed in 1995, and is located in Baton Rouge, Louisiana.

Q HAVE YOU PREPARED ANY ATTACHMENTS TO YOUR TESTIMONY OUTLINING YOUR QUALIFICATIONS IN ELECTRIC AND REGULATED INDUSTRIES?

A Yes. Attachment 1 to my testimony provides my academic vita that includes a full listing of my publications, presentations, and pre-filed expert witness testimony, expert reports, and affidavits.

Q WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A Our firm has been retained by Columbia Energy LLC, ("Columbia"), a subsidiary of Calpine Corporation ("Calpine"), to evaluate the reasonableness of South Carolina Electric and Gas Company's ("SCE&G" or "the Company") proposal to enter the remaining 42 percent of its recently completed Jasper Generating Facility into rates.

Q HOW IS THE REMAINDER OF YOUR TESTIMONY ORGANIZED?

A My testimony is organized into the following sections:

- Section II: Summary of Recommendations
- Section III: Summary of SCE&G's Position Regarding the Usefulness of the Jasper Generating Facility
- Section IV: Why the NCEMC Contract is So Important to the Company's Position on Cost Recovery of the Remaining Portion of the Jasper Facility
- Section V: The Company Should Be Denied Rate Recovery on the Remaining Portion of the Jasper Facility Because it Is Not Used and Useful
- Section VI: The Company Should be Denied Rate Recovery on the Remaining Portion of the Jasper Facility Because it Represents a Firm Sale to an Out-of-State Utility.

- Section VII: The Company Should be Denied Rate Recovery on the Remaining Portion of the Jasper Facility Since It Did Not Solicit the Market Prior to the Development of the Jasper Generation Facility
- Section VIII: The Commission Can Avoid Uncertainties Associated with Future Utility Generation Investment Decisions by Opening a Competitive Bidding Rulemaking
- Section IX: There is a Considerable Amount of Generation Available in the Southeast to Support a Competitive Bidding Process in South Carolina
- Section X: Recommendations

II. SUMMARY OF RECOMMENDATIONS

Q WOULD YOU PLEASE SUMMARIZE YOUR RECOMMENDATIONS?

A I recommend the Commission not allow the Company to recover any of the remaining costs associated with the Jasper Generating Facility until such time as the facility is used and useful for ratepayers. The remaining costs of the facility, along with the off-system sale contract revenues, should be separated for retail ratemaking purposes. The excess capacity associated with the Jasper Generating Facility is not needed at the current time to serve native load customers in South Carolina. If allowed into retail rates, this excess capacity will allow the Company to participate in competitive wholesale markets with the downside risks being borne by its captive retail ratepayers. In the past, the Commission has disallowed unused portions of generating facilities into rates. The Commission should exercise this precedent in the current proceeding.

Further, I recommend that the Commission initiate a rulemaking proceeding on competitive bidding. Requiring utilities to conduct a competitive bidding process prior to acquiring new resources will ensure that they have procured the most cost effective, flexible resource available in the market.

SECTION III: SUMMARY OF SCE&G'S POSITION REGARDING THE USEFULNESS OF THE JASPER GENERATING FACILITY

Q WOULD YOU PLEASE DISCUSS THE COMPANY'S DECISION TO BUILD THE JASPER GENERATING FACILITY.

A In 2001, SCE&G filed an application with the Commission for a "Certificate of Environmental Compatibility and Public Convenience and Necessity" (Docket No. 2001-420-E, hereafter "CON Proceeding"). The Company proposed to build an 875 megawatt ("MW") combined cycle ("CC") plant that was configured to include inlet chilling and duct firing to expand the capacity of its "3-on-1" (or "3 X 1") design (i.e., three combustion turbines and heat recovery steam generators with one steam generator). During the CON proceedings, the Company indicated the facility was needed to meet its need for 254 MW of additional capacity by 2004 and 480 MW by 2006.

Q WHY DID THE COMPANY BUILD SUCH A LARGE FACILITY IF IT ONLY NEEDED 480 MW BY 2006?

A The Company examined a number of different generation options to meet its future capacity requirements. The original design considered for meeting the Company's future need was to build a much smaller 449 MW CC plant that was essentially a "2-on-1" (or "2 X 1") design (i.e., two combustion turbines and heat

recovery generators with one steam generator). This configuration, as will be discussed later in my testimony, did not include inlet chilling or duct firing. The Company ultimately settled on building a much large 875 MW plant that included the "3 x 1" design (with inlet chilling and duct firing) discussed earlier. The Company indicated in its CON proceeding that there were considerable ratepayer benefits by going forward with this much larger facility. The additional capacity associated with building the larger unit is 426 MW (i.e., (875 MW – 449 MW)).

Q HOW DID THE COMPANY CHARACTERIZE THE BENEFITS ASSOCIATED WITH THE MUCH LARGER JASPER FACILITY?

A In the CON proceedings, the Company claims that there were considerable "economy of scale" benefits to ratepayers if they were allowed to develop the much larger unit. The Company informed the Commission that the average cost of developing the incremental capacity was much lower than the base capacity. These economies of scale have been characterized as being as high as 60 percent of the base capacity of the Jasper facility [Lorick Direct Testimony, Docket 2001-420-E, 4: 21-22.], to as low as 40 percent [Lynch Direct Testimony, Docket 2001-420-E, 8:18.] of that base capacity. The Company indicated that ultimately, this additional capacity would be needed by retail customers and that, in the interim, the excess capacity associated with the unit could be covered by a 250 MW off-system sales contract with the North Carolina Electric Membership Corporation ("NCEMC").

Q HOW DID THE COMMISSION RULE IN THE CON PROCEEDING?

A The Commission found, in its Conclusions, that the Company had established that it had a short fall in its ability to serve its customers and that additional capacity was needed. [South Carolina Public Service Commission, Docket 2001-420-E, Order No. 2002-19 at 13.]

Q HAS THE COMPANY BEEN ALLOWED COST RECOVERY ON ANY PORTION OF THE PLANT TO DATE?

A Yes, in the Company's last rate case (Docket No. 2002-223-E) it was allowed to enter 58 percent of the capital costs of the Jasper Generation Facility into rates as "construction work in progress" ("CWIP"). The Company maintained its position regarding the benefits of this facility despite protests by the Office of Consumer Advocate ("CA") and the South Carolina Energy Users Committee ("SCEUC"). Both interveners argued about the size of the facility and the need for the facility. Further, the CA took issue with the Company's decision making process in developing the Jasper plant and argued that the Company should have entered into a competitive bidding process.

Q HOW WOULD YOU SUMMARIZE THE COMMISSION'S RULINGS IN THE PAST TWO PROCEEDINGS REGARDING THE JASPER GENERATION FACILITY?

A The Commission has supported the Company's position that additional capacity was needed to serve retail load, and that constructing a larger unit would result in economies of scale relative to the originally considered 449 MW facility. The Commission noted in both proceedings that building the larger facility, and capturing the reported economies of scale associated with the

incremental capacity, would ultimately result in ratepayer benefits. The Commission did not, however, make a ruling on when these benefits would actually be secured for ratepayers, nor did the Commission give the Company complete upfront cost recovery approval for the entire facility. Further, in the last rate case, the Commission only allowed the first 58 percent of the Jasper facility into rates because the Commission believed the investments associated with developing that portion of the facility would be used and useful. The Commission did not, however, make a used and useful ruling on the other 42 percent of the Jasper Generating Facility. As I read the Commission's past orders, they have never given the Company upfront approval for recovering 100 percent of the costs of the entire 875 MW Jasper Generation Facility.

Q WHAT DO YOU SEE AS BEING THE IMPORTANT ISSUES BEFORE THE COMMISISON IN THIS PROCEEDING?

A In this case, the Commission will have to make a ruling on whether the capacity of the remaining 42 percent of the Jasper facility is used and useful for South Carolina customers. In my testimony, I will show that the Company should not be allowed to recover the remaining 42 percent of the facility in retail rates at this time. The Company should be given the opportunity to enter this capacity into rates at a future time when (1) it can prove that the capacity is used and useful and (2) provides explicit proof that the capacity is the least-cost alternative in the market by conducting a competitive bidding process.

SECTION IV: WHY THE NCEMC CONTRACT IS SO IMPORTANT TO THE COMPANY'S POSITION ON COST RECOVERY OF THE REMAINING PORTION OF THE JASPER FACILITY

Q WOULD YOU PLEASE DISCUSS THE NCEMC CONTRACTS?

A During the course of the CON proceeding, the Company indicated that it would enter into a 250 MW off-system sale to support a larger than needed capacity rating for the Jasper facility. The sale would have a term lasting from 2004-2012. After which time, the Company indicated the additional capacity would be needed, in its entirety, by its regulated customers. The Company explained to the Commission that the off-system sale would "more than offset any impact to, and in fact, benefit" customers [Lorick Rebuttal Testimony, Docket No. 2002-223-E, 3: 14-15.]

Q WHAT IS A FIRM TRANSACTION?

A A firm transaction is one that binds a seller to provide 100 percent reliability to a buyer. If the seller is unable to deliver on this transaction, a penalty is usually assessed. In many instances, this penalty is defined within the contract, and requires the seller to pay for the damages caused by a failure to deliver the electricity in accordance with the terms of the contract. These damages usually include the costs of replacement power. The terms of a firm contract, and the extra reliability associated with a contract of this nature, are not free. The buyer of a firm transaction usually must pay a premium for what is usually valued as a high-quality service.

Q WHAT IS A NON-FIRM TRANSACTION?

A A non-firm transaction is not guaranteed, and can be provided on a "recallable" or "as available" basis. Recallable sales, for instance, entitles the seller to recall a sale from the buyer under pre-defined terms. As available sales allow a buyer to purchase electricity when it is available by the seller – the buyer has no guarantee for this power at any other time. Sales of this nature are often referred to as "opportunity sales" because they are made when the opportunity arises between a buyer and seller. Because these sales are uncertain, they usually do not carry a premium.

Q WHAT IS THE DIFFERENCE BETWEEN A FIRM AND NON-FIRM CONTRACT?

A There are a number of differences, but one of the more important is the quality of the service provided under the different types of contracts. A firm transaction is one in which the buyer has paid a premium in order to get the service at all times, and in all manners, defined by the contract. It is a committed sale and represents a non-revocable obligation on the part of the seller (and buyer). The seller must provide that power and under most instances, will pay a penalty for failure to meet the terms of the contract.

Q WHY DOES IT MATTER FROM A RATEMAKING PERSPECTIVE WHETHER THE NCEMC CONTRACT IS FIRM OR NON-FIRM?

A If the NCEMC contract is recallable, it is non-firm, and if the transaction is non-firm, the ultimate responsibility for the facility in which the contract is tied rests with ratepayers, because they have the "right of first refusal" on the power

generated by the contract facility. The other purchaser gets the power only when the regulated customers do not need it.

Q HOW HAS THE COMPANY CHARACTERIZED ITS NCEMC CONTRACT?

A In two different manners. The Company states that the contract with NCEMC is firm, but recallable too. [Lorick Direct Testimony, 3: 20-23.] On the one hand, the Company characterizes the NCEMC contract as "recallable," or non-firm, and indicates that its regulated customers can have claim to the power when they need it for reliability and economic purposes. As a result, the Company is requesting that ratepayers pay for the costs of the additional capacity associated with the Jasper facility (which also facilitates the NCEMC off-system sale). If ratepayers are being asked to pay for this asset, and can make a claim on this power when needed, then the Jasper Generation Facility should be counted as a reserve that they can count on in a time of emergency. On the other hand, the Company explicitly defines the NCEMC contract as firm, and its analysis excludes the consideration of the capacity tied to this contract in estimating the total reserves for regulated customers. If the contract capacity was included as a resource in the calculation, it would result in reserve margins that are well in excess of what the Commission has recognized as reasonable, and the Company has used for planning purposes.

Q DO YOU THINK THE COMPANY IS TRYING TO HAVE IT "BOTH WAYS?"

A Yes. The Company tries to justify its development of the additional capacity at Jasper as an asset for South Carolina ratepayers that they can count upon in times of emergency. The Company also notes that it can recall the contracted capacity (created by the development of Jasper) from the NCEMC contract for economic purposes as well. [Response to Columbia Energy RFI 3-3(b).] The Company is asking ratepayers to assume the responsibility for this extra capacity in return for this insurance. However, the Company expects the Commission to disregard this additional capacity in its analysis of the Company's reserves because it is tied to the NCEMC contract, which apparently takes on "firm power" characteristics for the calculation. The problem is that including the contracted capacity (created by Jasper) results in exceptionally large reserve margins that are unneeded to serve regulated South Carolina customers. If the capacity associated with the NCEMC contract is truly unneeded by South Carolina ratepayers, then it has no place in retail rates, and the costs associated with the additional capacity at Jasper, and NCEMC revenues purported supporting that capacity, should be removed for retail ratemaking purposes.

Q HAS THE COMPANY CONDUCTED ANY STUDIES WHICH ATTEMPT TO DETERMINE THE LIKELIHOOD THAT THEY WOULD EVER NEED THIS CAPACITY FOR ITS RATEPAYERS FOR ECONOMIC OR RELIABILITY PURPOSES?

A No. The Company has noted that "no specific statistical analysis" has been performed to determine the likelihood of recalling the power tied to the NCEMC contract for its native load customers. [Response to Columbia Energy

RFI 2-3(j).] The Company further to notes that, more generally, no specific analyses of "any kind" were conducted to examine the likelihood of an energy recall to meet native load requirements. [Response to Columbia Energy RFI 3-6.]

Q WHAT IS YOUR POSITION ON THE NATURE OF THESE NCEMC CONTRACTS?

A Either way the Commission examines this issue, it should come to the conclusion that the additional capacity created by Jasper is a bad deal for South Carolina ratepayers. If the NCEMC transaction is firm, then the additional capacity which facilitates this out-of-state (wholesale) sale needs to be completely removed from retail rates and not recovered in any fashion from South Carolina ratepayers. If the contract with NCEMC is not firm, and is recallable to ratepayers in South Carolina, then the excessive capacity that the Company developed under the auspices of "economies of scale" is not used and useful, the Company did not conduct any studies on whether this recallable option would ever be needed, and therefore should not be allowed into retail rates. I will discuss each of these positions, in further detail, in the following sections of my testimony.

SECTION V: THE COMPANY SHOULD BE DENIED RATE RECOVERY ON THE REMAINING PORTION OF THE JASPER FACILITY BECAUSE IT IS NOT USED AND USEFUL

Q WHAT IS A RESERVE MARGIN?

A A reserve margin is a ratio of excess capacity divided by total peak demand. This ratio is a summary statistic that represents the amount of spare

generation a utility has relative to its peak demand. The spare generation statistic (or "margin") is calculated by subtracting peak demand from all of the generation resources that a Company can call upon to serve customers. This margin represents extra capacity that a utility can use in times of an emergency.

Q WHAT PURPOSES DOES THE RESERVE MARGIN SERVE?

A Reserve margins are often used for utility planning, as well as for some regulatory purposes. Historically, the Company's acceptable planning range for its reserve margin has been 12 to 18 percent. This means that if reserve margins slip below 12 percent, the Company should consider acquiring new resources. Margins above 18 percent can be considered beyond what the Company needs to reliably serve its customers.

Q WHY DO YOU THINK THE ISSUE OF SCE&G'S RESERVE MARGIN IS IMPORTANT IN THIS PROCEEDING?

A This measure, more than any other, shows just how unnecessary the remaining 42 percent of the Jasper Generating Facility is to South Carolina ratepayers. Consider that the Jasper facility represents a sizable capacity addition for the Company. The project never needed to be as large as it was ultimately developed, yet the Company, from the CON proceeding until today, justified this unnecessary capacity on the grounds of capturing the purported economies of scale associated with the project's construction costs. The problem is that, even if the economies of scale argument is accepted, the Company still has too much capacity for native load customers, regardless of how cheap it is on an incremental basis.

Q WHAT INCENTIVE DOES SCE&G HAVE TO REPRESENT THEIR RESERVE MARGINS AS BEING LOW IN THIS PROCEEDING?

A The Company needs to show that its reserve margins are reasonable and within historically accepted ranges. If the forecasted margins rise above these boundaries, then it shows that the additional capacity created by building Jasper as a larger unit is unneeded. SCE&G has an incentive to use the most favorable method possible to calculate its reserve margins, and hide the fact that it currently has excess capacity for its native load customers.

Q DO YOU THINK THE COMPANY'S RESERVE MARGINS ARE EXCESSIVE?

A Yes, when appropriately calculated, these margins are excessive. As I will discuss later in my testimony, there is considerable evidence to show that the reserve margins provided by the Company in this filling are not an accurate reflection of the excess capacity that it is asking its ratepayers to fund. The Company attempts to use a method of calculating reserve margins that is favorable to its position that Jasper is used and useful.

Q WHY ARE THE COMPANY'S ESTIMATES FAVORABLE TO THEIR POSITION?

A The Company's estimates completely discount the additional capacity created by Jasper because this additional capacity is purportedly tied to the NCEMC contract. Removing the additional capacity (because of the NCEMC contract) gives the illusion that the reserve margin is reasonable. As I noted earlier, the Company cannot have it both ways – if the additional capacity is tied

up in a firm contract to be exported to North Carolina customers, then it should not be included in South Carolina rates since it is not used and useful. If the contract is recallable, as the Company has suggested in this proceeding, then it needs to be included in the reserve margin calculation. The Company has explicitly stated that the capacity is recallable. [Lorick Direct Testimony, 3:23.] If this is true, the additional capacity associated with Jasper should be included in the reserve margin calculation. If the capacity is included in the reserve margin calculation, it results in a level that is well beyond what was represented to the Commission in the CON proceeding, and what is reasonable relative to the Company's historic planning levels.

Q EVEN ASSUMING THE COMPANY'S CALCULATIONS ARE CORRECT, HAVEN'T THEY ADMITTED THAT THE ADDITION OF JASPER RESULTS IN RESERVE MARGINS GREATER THAN THOSE TYPICALLY USED FOR PLANNING PURPOSES?

A Yes. The Company has noted that it anticipates a 19.8 percent reserve margin based upon its 2004 forecasted peak territorial demand. [Lorick Direct Testimony, 3: 13-14.] This forecasted reserve margin, based upon the Company's calculations, is higher than the reserve margin typically used by the Company for planning purposes (and recognized by the Commission in the CON proceeding) which ranges somewhere between 12 to 18 percent. Thus, even the Company admits that its current reserve margin is almost 2 percent above the **upper band** (not the mid-point) of this recognized reserve margin.

Q WHEN DOES THE COMPANY'S FORECAST ANTICIPATE THAT THESE EXCESS LEVELS WILL DISSIPATE?

A Exhibit DED-1 provides the Company's forecasted reserve margins for the next 15 years as calculated from their 2004 Integrated Resource Plan ("IRP"). The Company anticipates that this excess level of capacity will dissipate over time starting in 2005 when reserve margins fall slightly below 18 percent. This level is preserved until 2007 when reserve margins fall to around 15 percent. The Company is not anticipating making another resource addition until 2009.

Q DO YOU THINK THE COMPANY'S CURRENT PEAK DEMAND FORECASTS ARE OPTIMISTIC?

A Yes. The Company is assuming an annual average peak demand growth rate of 2.3 percent for its forecast period of 2004-2010. This growth rate seems somewhat optimistic, particularly given current trends in past forecasts that have been provided by the Company, and forecasts from the VACAR sub-region of SERC, both of which show much slower annual average rates of growth. For instance:

- In the Company's last rate case, it forecasted an average annual growth rate of some 1.9 percent for the same period (2004-2010).
- The Company's 2000 IRP shows an annual average growth rate for the same period as being slightly lower at 2.1 percent annually.
- The Company's recent fuel forecast also shows an annual average growth rate of 2.1 percent.

- The NERC demand forecast for the VACAR region over the next 8 years is 2.1 percent.

Exhibit DED-2 provides a comparison of these different forecasts.

Q HOW HAS THE COMPANY CHARACTERIZED THE OFF-SYSTEM SALES THAT SUPPORT THE DEVELOPMENT OF THE EXTRA CAPACITY AT THE JASPER FACILITY?

A The Company has participated in two proceedings prior to the current rate case that have addressed forecasted need issues supporting the development of the Jasper facility. This includes the Company's CON (Docket No. 2001-420-E) proceeding and its most recent rate case (Docket 2002-223-E) in which 58 percent of Jasper was included in rate base as "construction while in progress" ("CWIP"). In each of the petitions supporting the Company's filings, they noted that there would be a 250 MW sale to the NCEMC. In fact, even in this proceeding, the Company has pointed to this 250 MW off-system sale as justification for the excess capacity created by the development of Jasper as a much larger facility. [Lorick Direct Testimony, 3:20-23; 4: 1-4.]

Q ARE THERE ANY OTHER OFF-SYSTEM SALES TO NCEMC OTHER THAN THE 250 MW CONTRACT DISCUSSED IN THE PRIOR TWO PROCEEDINGS?

A Yes. The Company has entered into an additional 100 MW sale with NCEMC for the next two years which even further supports the illusion of an appropriate reserve margin. This increases total off-system sales for 2004 and

2005 to 350 MW. The 100 MW contract ends in 2005. Total off-system sales will be 250 MW for the period 2006-2012.

Q HOW WAS THE COMMISSION NOTIFIED ABOUT THESE 100 MW CONTRACTS?

A The Company does not appear to have clearly explained to the Commission that it has had to enter into an additional 100 MW sale with NCEMC. The only instance in which the Commission was made aware that the additional 100 MW sale would take place was in general comments made by two different Company witnesses during the last rate case (Docket No. 2002-223-E). For instance, in cross examination Mr. Marsh noted that "I believe there may be another hundred megawatt block on top of that that's been sold for 2004 and 2005." [Response to Columbia Energy Interrogatory 2-5(j).] Mr. Landreth, also in cross examination during the hearing, noted that "...an additional 100 megawatts of system energy" would be sold. [Response to Columbia Energy Interrogatory 2-5(j).] Even the Company seems to be confused about when it exactly notified this Commission that it was entering into an additional sale to off-load the additionally-recognized excess capacity created by Jasper. In discussing the timing of the 100 MW sale in discovery, the Company notes that "...[s]ince these orders were issued, [i.e., after the issuance of the CON and Rate Case Orders] the Company has been able to sell an additional 100 MW of system capacity to NCEMC." [Response to Columbia Energy RFI 2-10.] Thus, based upon the Company's discovery response, it did not enter into these contracts until both proceedings had been closed.

Q DO YOU THINK THIS POINT WAS MADE CLEARLY TO THE COMMISSION IN THE PRIOR RATE CASE PROCEEDING?

A No. In fact, from examining the Commission's Final Order, it would appear that they may not have recognized that the Company had to enter into an additional 100 MW sale because of the growing excess capacity created by building Jasper as a much larger than needed facility. In the discussion of the off-system sales supporting the development of the additional capacity at Jasper, the Commission noted in its Order that "...the Company has been able to sell 250 MW of system capacity to third parties based on the reserves Jasper will represent when it comes on line." [Docket No. 2002-223-E, Order No. 2003-38]. Nowhere in the Commission's Order for the last rate case is the additional 100 MW sale referenced.

Q WHAT ARE THE COMPANY'S RESERVE MARGINS IF THE CAPACITY ATTRIBUTABLE TO THE NCEMC OFF-SYSTEM SALES CONTRACTS ARE COUNTED AS A SUPPLY SIDE RESOURCE?

A The reserve margins are considerably higher if the "recallable" off-system sales are included in the calculation. These reserve margin estimates have been provided in Exhibit DED-3. Reserve margins are 29.1 percent in 2004, and in excess of 20 percent for every year until 2008 when they return to a level slightly above 18 percent through to 2012.

Q IS IT APPROPRIATE TO EXCLUDE THESE CONTRACTS FOR PURPOSES OF CALCULATING THE RESERVE MARGIN?

A Not if you accept the Company's position that the capacity sold to NCEMC is recallable for native load customers. If the capacity associated attributable to the contracts is truly recallable, then it represents a supply-side resource, and should be included in the calculation of the reserve margin. The very purpose of this measure is to estimate the amount of reserves a utility will have in case of an emergency. If the Company is correct, and can recall this capacity for an emergency to serve its own native load customers, then it should be counted in the reserve margin estimate. Recallable resources are used by the SERC in examining its own regional reserve and capacity margins. SERC, for instance, uses capacity that is committed to load, including recallable resources such as load management and interruptible contracts. Recallable generation is the supply-side equivalent to load management and interruptible contracts, and should be used in making the reserve margin calculation.

Q WHEN THE COMPANY PRESENTED ITS CASE IN THE CON PROCEEDINGS, WHAT RESERVE MARGINS DID THEY PROVIDE AS JUSTIFICATION FOR THEIR SUPPLY DECISIONS?

A The Company actually supported a "mid-range" reserve margin in the original CON proceeding. This "mid-range" is a mid-point between the traditionally accepted range of 12 percent to 18 percent. Exhibit DED-4 replicates the Company's Peak Demand, Reserve Margin, and Supply schedule that was provided in the CON proceeding. This table was originally provided as JML-2. It is important to note that the table provided in the CON proceeding uses a "mid-range" reserve margin for planning purposes, and not the upper end of the

reserve margin planning range (18 percent) that the Company is adopting as reasonable in this proceeding.

Q. HOW DO THE REQUIRED SUPPLY ESTIMATES PROVIDED BY THE COMPANY IN THE CON PROCEEDING DIFFER FROM THOSE PROVIDED IN THE CURRENT CASE?

A Exhibit DED-5 provides a comparison of the Company's estimated supply requirements during the CON proceeding, and the forecasted amount of capacity that will be available to the Company to serve retail customers if the remaining 42 percent of Jasper is allowed into retail rates. This "supply required" was originally provided in column E of Exhibit No, JML-2. As seen from the exhibit, the difference between what the Company told the Commission they would need in the CON proceeding, and the capacity that will now be available to customers (with and without the off-system sales to NCEMC) are considerable. The differences amount to as much as 300 MW for each year until 2010 even if the 350 MW off-system sales contracts with NCEMC are inappropriately backed out of the calculation.

Q WHAT ARE THE RESERVE MARGINS USING THE PEAK DEMAND ESTIMATES PROVIDED BY THE COMPANY IN ITS MOST RECENT FUEL FILING?

A These margins are also high, particularly in the near term, and have been provided in Exhibit DED-6. The reserve margins for 2004 are 20.5 percent and slightly over 18 percent for the period 2005-2006. It is not until 2007 that these reserve margin numbers start to fall into acceptable planning ranges. These

reserve margin estimates have included the capacity associated with the NCEMC contracts as a potential resource that can be called upon during an emergency (i.e., "recalled").

Q WHAT WOULD THE COMPANY'S FORECASTED RESERVE MARGINS LOOK LIKE IF THE REMAINING 42 PERCENT OF THE JASPER FACILITY WERE NOT ALLOWED TO BE PLACED INTO RATES?

A Exhibit DED-7 shows the Company's forecasted reserve margins without the additional 42 percent of the Jasper facility. Five columns have been presented. The first shows the reserve margins under the Company's current forecasted load growth which averages to around 2.3 percent per year. The middle three columns examine the potential reserve margins under a number of different forecasts provided by the Company in prior filings. Estimated reserve margins based upon the most recent VACAR forecast have been provided in the last column. The exhibit shows that, even without the 42 percent of Jasper, the Company's reserve margin will not fall below 15 percent, the mid-range in the Company's reserve margin planning criteria, until 2007. These margins will not fall below 12 percent until 2008.

Q WHAT CONCLUSIONS DO YOU MAKE REGARDING THESE VARIOUS RESERVE MARGIN ESTIMATES?

A The extra capacity created by building the Jasper Facility as a much large project is not used and useful today, and the additional amount of the capacity will probably not be needed for regulated customers until sometime in the future.

Q WHAT ACTION WOULD YOU PRESCRIBE TO THE COMMISISON SINCE THIS CAPACITY IS NOT USED AND USEFUL?

A The costs associated with the remaining 42 percent of Jasper, and the revenues associated with the two NCEMC contracts, should be separated, and excluded for retail ratemaking purposes. In some ways, this recommendation is similar to a disallowance. Disallowances are the traditional regulatory mechanism for dealing with utility investments that are not used and useful.

Q HAS THE SOUTH CAROLINA COMMISSION EVER DISALLOWED THE ENTRY OF ANY PORTION OF AN UNNEEDED PLANT INTO RATES?

A Yes. In the early 1980s, SCE&G attempted to recover the costs associated with the Summer Nuclear Generating Facility once it was completed. The costs associated with the plant were considerable, as well the increase in overall generating capacity. In Order No. 84-1427 (Docket 83-307-E) the Commission recognized that ratepayers should not bear the burden of the costs of the unneeded capacity. The Commission noted that the capacity associated with the facility resulted in "excess generation reserves." [Docket No. 83-307-E, Order No. 84-142, 29: ¶15.] As a result, the Commission accepted a Staff recommendation that effectively disallowed 400 MW of the Company's average production plant (the exclusion of some $123 million). [Docket No. 83-307-E, Order No. 84-142, 29: ¶15.]

Q DO YOU THINK THE ISSUES THEN ARE SIMILAR TO THE ONES UNDER CONSIDERATION BY THE COMMISSION IN THIS PROCEEDING?

A Yes. The issue in Docket 83-307-E is similar in nature to the one currently being considered by this Commission. In the prior case, the Company was attempting to include into rates a considerable amount of capacity that was not needed to serve regulated native load customers. The inclusion of this capacity would have resulted in reserve margins that were considerably in excess of those traditionally accepted by the Commission. While the Commission allowed the Company to recover some portion of the costs associated with the Summer facility, it disallowed a considerable portion of the remaining costs since it contributed to "excess generation reserves." In this current proceeding, SCE&G has already been allowed to recover 58 percent of the Jasper plant investment. The question before the Commission now is whether the unneeded remaining 42 percent of this plant should be recovered in rates.

Q FROM A GENERAL REGULATORY POLICY PERSPECTIVE, IS IT APPROPRIATE FOR PLANTS THAT ARE NOT USED AND USEFUL TO BE ENTERED INTO RATES?

A No, a fundamental principle in regulatory policy is the concept of "used and useful." This concept suggests that only those costs and investments that are used and useful for the provision of service by a utility to its regulated customers should be recovered in rates. Costs or investments not associated with the provision of service should not be included in rates. The cost of these investments should be borne by the utility and its shareholders. Costs or investments that are determined to be not used and useful, and are not allowed into rates, are often said to be "disallowed" by a regulatory commission.

Q WHY ARE DISALLOWANCES USED BY REGULATORS?

A One of the main reasons disallowances are used by regulators is to impose some discipline on the part of the regulated industries. In competitive markets, if management makes bad decisions, profitability is usually impacted, and shareholders are held accountable for these poor decisions through lower earnings and share prices. Disallowances provide a "check," much like competitive market forces, on regulated companies by holding them equally accountable for bad decisions. This disallowance process is used to temper the tendency of regulated industries to "gold plate" their investments and expenses.

Q DOES YOUR RECOMMENDATION DIFFER FROM A MORE TRADITIONAL DISALLOWANCE RECOMMENDATION?

A Yes, I would argue that my recommendation is not as severe as past disallowance decisions. In traditional disallowance situations, particularly those associated with nuclear power plants, there have usually been no off-system sales to support the unrecoverable (disallowed) costs of a particular facility. Removing the remaining portion of Jasper is not as severe as past disallowances since there are revenues that give the Company the opportunity to recover the costs of additional capacity created by the Jasper facility. If the revenues recover the costs of the additional capacity, then the Company and its shareholders may not be penalized as severely as they would have been if the NCEMC contracts were not in place. Further, under my recommendation, the Company will have the opportunity to bid this capacity into a competitive bidding process at a later date when the capacity is needed by ratepayers.

Q HAS THE COMPANY NOTED THAT THE REVENUES FROM THE OFF-SYSTEM SALES TO NCEMC WILL "MORE THAN OFFSET" THE COST OF THE ADDITIONAL CAPACITY AT JASPER?

A Yes. During the course of the Company's last rate case (Docket 2002-223-E), the Company indicated that the 250 MW sale to NCEMC would more than offset any impact to, and actually benefit customers. The Company, in referencing the benefits of the off system sale specifically noted:

> ...we have sold 250 MW off system, which more than offsets any impact to and, in fact, benefits our customers. [Lorick Rebuttal Testimony, Docket 2002-223-E. 3: 14-15.]

Q IS IT STILL THE COMPANY'S POSITION THAT THE REVENUES ASSOCIATED WITH THE OFF-SYSTEM SALE WILL MORE THAN COVER THE INCREMENTAL COSTS OF JASPER?

A Yes. The Company has explained in this proceeding that revenues from the NCEMC contract will still offset the incremental capacity associated with Jasper. In fact, the Company has noted that since the time of the Commission's past Orders on the Jasper facility:

> ... the Company continues to believe that the NCEMC contracts off-set the additional cost of proceeding with construction of Jasper Plant as a three-unit, 875 MW plant. [Response to Columbia Energy RFI 2-10(a).]

Q WILL THE COMPANY BE HARMED IF THE ADDITIONAL COSTS OF JASPER ARE NOT INCLUDED IN RATES?

A If revenues are truly offsetting the costs of building a larger Jasper facility, then the Company and its shareholders will not be harmed if the additional cost of the larger facility, along with the revenues from the NCEMC contracts, are treated as non-jurisdictional and essentially removed from the retail rate base, revenues, and expenses for purposes of setting rates in this proceeding. One could also try to make the inverse argument as well: that leaving the transaction in rates does not harm customers. This argument suffers from a number of problems.

Q WHY COULD YOU NOT MAKE THE INVERSE ARGUMENT THAT ALLOWING THE REMAINING PORTION OF JASPER INTO RATE BASE WOULD NOT HURT CUSTOMERS?

A The Company has not demonstrated that the incremental cost of the larger facility is offset by the revenue generated from the NCEMC contracts, nor has it conducted any analysis to prove this point in the current or prior proceedings. [Response to Columbia Energy RFI 2-10 and 3-14.] The only issue that the Company has attempted to quantitatively prove is that there were some purported economies of scale associated with building a larger unit. As I will discuss in a later section of my testimony, the analysis upon which this comparison was based is faulty. The Company's failure to prove this fundamental point (that the revenues from the contract cover the costs of developing the additional capacity), and its failure to even conduct any studies to prove this point, should send a red flag to the Commission that ratepayers at least have the potential to be placed at risk.

Q HOW DO YOU INTERPRET THE COMPANY'S POSITION ON DEVELOPING JASPER AS A MUCH LARGER FACILITY?

A The Company's whole premise in constructing the additional capacity at Jasper (i.e, building an 875 MW plant as opposed to a 449 MW plant) was to secure the purported benefits of the economies of scale of a larger unit. In the CON proceeding, the Company claimed that "at some point" its regulated customers would need new generation resources. [Lynch Direct Testimony, 8: 20.] Thus, according to the Company's logic, if the proposed generation facility were to be "super-sized" today, the cost savings associated with the economies of scale could be passed along to ratepayers tomorrow. In the meantime, the Company proposed to enter into a contract with NCEMC with this unneeded capacity. The Company informed the Commission that this would result in a benefit for ratepayers. The Company's current proposal to include the remaining 42 percent of Jasper into rates essentially asks the Commission to accept today's costs for the additional capacity, and place them into today's rates for retail customers, for a benefit that, even if accepted, will occur sometime in the future.

Q DO YOU AGREE WITH THESE BENEFITS?

A While the "economies of scale" idea has appeal on its surface, it is riddled with problems, and puts the Commission in a regulatory bind. The Company's proposal essentially asks this Commission to "pre-approve" the need and the costs of the entire Jasper facility much in advance of the entire resource being used and useful for South Carolina ratepayers. If the entire capacity is not

needed today, then the Commission should defer its judgment on the issue of allowing this unneeded capacity into rates until a future date when it can insure that the capacity is needed and is the least cost resource available to the Company to serve its ratepayers through a competitive bidding process. The Commission can easily do this by not allowing the additional costs and associated off-system sales contract revenues into the retail cost of service. If the Company's representation about the NCEMC contracts covering the costs of developing the additional capacity is correct, then there is no harm to the Company by removing these costs from retail rates. More importantly, this decision would benefit ratepayers by protecting them from any potential risks of under-recovery of costs for a facility that they will not need until sometime in the future.

Q CAN RATEPAYERS STILL GET THE BENEFITS OF THESE ECONOMIES OF SCALE IN THE FUTURE EVEN IF THE ADDITIONAL CAPACITY IS NOT ENTERED INTO THE COMPANY'S RATES IN THIS PROCEEDING?

A Yes. If the need for the capacity arises in the future once the contract with NCEMC has expired, then the Company can offer this capacity, including its associated economy of scale benefits, to South Carolina ratepayers. Until that time, the Company, its shareholders, and North Carolina ratepayers, need to assume the risks associated with the additional capacity at the Jasper facility supporting the off-system sale.

Q DO YOU AGREE THERE ARE BIG COST SAVINGS ASSOCIATED WITH BUILDING THE LARGER UNIT?

A It is not clear whether there are truly any large economies of scale benefits from having built the larger facility. I have not been allowed to make these comparisons because the Company has objected to a number of data requests offered by Columbia Energy in this regard. The Company has objected to Columbia's request for information on the grounds of "relevance given the fact that siting issues related to the Jasper County Plant have already been finally and conclusively determined as set forth in the Company's Motion for Protective Order filed in this Docket." [Response to Columbia Energy's RFI 3-31.] I would like to reserve the right to supplement or correct my testimony should the Company provide such information during the course of this proceeding.

Q DO YOU THINK THE COMPANY'S ANALYSIS IN THE CON PROCEEDING MAY BE FAULTY?

A It could be. One of the big problems with the analysis presented by the Company in prior proceedings is that they did not provide this Commission with an "apples-to-apples" comparison of the costs of building a similarly designed 449 MW unit to the larger 875 MW unit.

Q WHAT DO YOU MEAN?

A In the CON proceeding, the Company presented a number of analyses in Exhibit JML-4 that attempted to show that the larger 875 MW Jasper configuration was the lower cost option of those considered. A replica of this analysis has been presented in Exhibit DED-8. In the analysis, the Company

compared a simple 2 x 1 design, which would result in a 449 MW configuration, to a much larger 3 x 1 design which would result in the current 875 MW configuration. The problem with the two analyses is that the smaller unit (2 x 1) was not designed the same as the larger (3 x 1) unit. The smaller unit did not have inlet chilling or supplemental duct firing: the larger unit did. So, it is an "apples-to-oranges" comparison since the smaller unit (449 MW unit) did not have the additional equipment included with cost analysis of the larger 875 MW unit.

Q WHAT DOES THIS ADDITIONAL EQUIPMENT DO TO THE OVERALL COST PER INSTALLED MW?

A When these additional applications are added to a project, they tend to drop the overall cost per installed MW since the unit costs are incrementally cheaper. The addition of inlet chilling and duct firing can result in some relatively cheap MWs being added to a project. If these applications are added to the larger project, but not the smaller one, then the overall average costs per installed MW of the larger project are going to be lower.

Q DO YOU HAVE AN ANALOGY?

A Yes, looking at the installed cost per MW of these different configurations is not unlike looking at the cost per square feet of building a home. The "big ticket" costs in building a home are usually with bathrooms and kitchens. Adding a 500 square foot garage to a standard design, for instance, is relatively less expensive since it usually has no plumbing, no appliances, and usually limited electrical work. If you were to examine the average costs of building a home

without the garage, to the one with the garage, the cost per total square foot would probably be lower than the one without the garage – even though the home with the garage is approximately 500 square feet larger.

Q SO HOW DOES THIS WORK WITH DIFFERENT POWER PLANT CONFIGURATIONS?

A The inlet chilling and duct firing, like the garage, are relatively cheaper MWs to add to a power plant configuration. If you are comparing a plant that includes these applications, to one that does not, then the costs are going to be lower on an average cost basis for the project that includes these additions. The Company's analysis in the CON proceeding did not include these relatively cheap MWs for the smaller 449 MW unit. If it had, the result could very easily have been that the increase in MW could have been much greater than the increase in costs. Mathematically, this would have driven overall average costs per unit down for the smaller 449 MW unit, and made it more comparable to the current Jasper design. It has been difficult, however, for me to assess the Company's original analysis because the Company has not provided this information in the discovery process.

Q EVEN IF THE COMPANY'S ANALYSIS ABOUT THE ECONOMIES OF SCALE IS CORRECT, DOES IT CHANGE YOUR CONCLUSIONS?

A No, because ultimately, it does not matter how cheap the additional MW of capacity are on an average cost basis, this capacity is not used and useful for ratepayers today, and is not expected to be useful for customers until sometime in the future. Ratepayers should not be required to pay for a large amount of

unneeded capacity that will only serve to support an off-system sale. When these MW are needed for ratepayers, the Company should be allowed to bid them into a competitive bidding process to ensure that the least cost resource is being secured by its customers.

Q HAVE YOU ATTEMPTED TO ESTIMATE THE REVENUE REQUIREMENT ASSOCIATED WITH THE COSTS OF THE ADDITIONAL JASPER CAPACITY AND THE NCEMC CONTRACT REVENUES?

A Yes I have made a several assumptions in order to determine if the additional capacity developed by the Company at Jasper are covered by the NCEMC revenues. I have had to make a number of assumptions since the Company has not been forthcoming in discovery in providing the information needed to make this calculation and has stated to date that it has conducted no such analysis itself. I would like to reserve the right to supplement my testimony at a later date should new information arise in this proceeding.

Q WHAT ARE THE IMPACTS?

A Exhibit DED-9 estimates the costs associated with developing the additional capacity (875 MW less 449 MW) at the Jasper plant, which in turn is partially offset by the revenue from the off-system sales to NCEMC. As depicted in this exhibit, during the first year of operation, the capital and O&M cost of the additional Jasper capacity produces a retail revenue requirement impact estimated to be $55 million. The effect of including the revenues from the contracts with NCEMC offsets this revenue requirement by $38.5 million, producing an overall retail revenue requirement shortfall of $16.3 million during

the test year. I have also estimated the impact for the second and third years of operation. As shown, in the second year, the retail revenue requirement shortfall is $15.2 million. In the third year the retail revenue requirement shortfall increases to $23.5 million due to the expiration of the 100 MW sale to NCEMC.

Q WHAT IS THE TOTAL IMPACT TO RATEPAYERS OVER A THREE YEAR PERIOD?

A In total, for the first three years of operation, the cost of the additional capacity, roughly 426 MW (875 MW less 449 MW), at of the Jasper plant, offset by the NCEMC revenues, produces a retail revenue shortfall of $55.2 million. It would appear then, that the Company's contention that the revenues from the NCEMC contract are covering this additional capacity at Jasper is not accurate.

Q COULD YOU SUMMARIZE ALL THESE POINTS?

A Yes. In addition to the other arguments discussed earlier in my testimony, the Commission should disallow the inclusion of the remaining portion of the Jasper project since:

(1) The Company has noted that the revenues from the NCEMC contract cover the additional costs of building the larger facility. If this assertion is true, then the Company will not be harmed by separating the costs associated with the additional Jasper capacity (and the NCEMC contract revenues) from retail rates. If this assertion is not true, the retail ratepayers should not be held accountable for the unneeded capacity;

(2) Allowing the remaining 42 percent of the Jasper facility into rates sets a bad regulatory precedent since it pre-approves capacity that is not used today.

(3) The Commission should use caution in allowing the remaining costs of this facility into rates today based upon the Company's "economies of scale" argument. The Company's prior analyses were not conducted on "apples-to-apples" basis, and they have failed to conduct any updated analyses to support this claim.

SECTION VI: THE COMPANY SHOULD BE DENIED RATE RECOVERY ON THE REMAINING PORTION OF THE JASPER FACILITY BECAUSE IT REPRESENTS A FIRM SALE TO AN OUT-OF-STATE UTILITY

Q HOW HAS THE COMPANY CHARACTERIZED ITS OFF-SYSTEM SALE WITH NCEMC?

A The Company has characterized the sale as firm, but places a caveat on this characterization by noting that the sale is "recallable" in nature and, as a result, is not completely firm. As noted earlier, the distinction between a firm and non-firm contract is important in this proceeding. If the NCEMC contract is indeed firm, as the Company notes, then it should be jurisdictionally separated for retail ratemaking purposes. If the contract is not firm, and "recallable" as the Company indicates, then the capacity associated with the recallable rights should be counted in the reserve margin calculation. This results in excess and unused capacity. In either case, the additional capacity should not be included in retail rates.

Q HAVE YOU REVIEWED THE NCEMC CONTRACTS?

A No, the Company has objected to Columbia Energy's review of the NCEMC contracts and has also objected to answering certain questions about contract specifics. Columbia Energy has protested the Company's objection. The Commission recently approved a framework through which the parties should work through the issues associated with disclosing certain information about the NCEMC contracts. At the time of my testimony preparation, Columbia and the Company have not been able to work out details on making certain information about these contracts available. I would like to reserve the right to supplement and clarify my direct testimony should I be allowed to review these contracts or certain details about contract specifics.

Q WHAT IN PARTICULAR LEADS YOU TO BELIEVE THAT THIS CONTRACT IS FIRM?

A Every piece of publicly available information about the NCEMC contract explicitly notes that the purpose of the contract is to acquire ***firm capacity***. Four pieces of information are instructive in examining this point. The first is the RFP that NCEMC submitted to the market soliciting resources, which the Company ultimately won. The second is how this contract has been characterized by the North Carolina Public Utilities Commission in its annual report to the North Carolina Legislature. The third is the Company's own representation in its most recent IRP. The fourth is a July 2004 report prepared by NCEMC to the Rural Utilities Service ("RUS"). All of this information concludes that the NCEMC

contracts with SCE&G are firm, and none mention in any fashion that SCE&G has any recallable provisions associated with the contracted capacity.

Q WHAT DOES THE RFP SAY ABOUT THE FIRMNESS OF THE RESOURCES NCEMC WAS SEEKING IN THE MARKET?

A Section 3.3 of NCEMC's RFP, which was ultimately awarded to SCE&G, addresses the issue of the "Firmness of Capacity Resources." In this section, NCEMC indicated that it "...will evaluate all proposals based on a level of firmness and availability equal to 100 percent." [Response to Columbia Energy 2-3(b).] NCEMC further notes that "Although liquidated damages will be required for all proposals, a proposal that is only financially firm will not be considered equivalent to a proposal that is system firm or tied to a portfolio of resources." [Response to Columbia Energy 2-3(b).] The NCEMC RFP does not mention any willingness to accept offers that have recallable provisions.

Q WHAT ARE THE REQUIREMENTS OF TRANSMISSION SERVICE ASSOCIATED WITH THE NCEMC CONTRACT?

A NCEMC, in Section 3.3 of the RFP, also notes that transmission service used to deliver the power should be provided "over a firm transmission path to the proposed interface." [Response to Columbia Energy 2-3(b).]

Q HOW DID NORTH CAROLINA COMMISSION CHARACTERIZE THE NATURE OF THE NCEMC-SCE&G CONTRACT BEFORE THE NORTH CAROLINA LEGISLATURE?

A They have characterized these resources as firm. Every year, the North Carolina Utilities Commission ("NCUC") provides an annual report to the North

Carolina Legislature with its analysis of the existing status and long-range resource needs in North Carolina. As noted by the NCUC, much of the information provided in the report comes from the individual utilities and their own individual resource plans. Exhibit DED-10 provides Table 2.1 and Table 2.2 of the report which shows the projected summer and winter loads and capacity, respective. Footnote 4 of this report clearly states: "NCEMC assumes all [SCE&G] capacity purchases will be **100 percent firm** with reserves provided by the supplying entity." [NCUC Annual Report to the North Carolina Legislature, Table 2.1, 2.2; emphasis added.]

Q HOW HAS THE COMPANY CHARACTERIZED THE SALE OF THE FACILITY IN ITS IRP?

A The sale has been clearly characterized as a firm sale. Page 9 of the Company's 2004 IRP has been included as Exhibit DED-11. Row 4 of the table is entitled "Firm Contract Sales" and is listed as 350 MW for 2004 and 2005, and listed as 250 MW for the period 2006 to 2012: the period for the NCEMC contracts.

Q HOW DID NCEMC CHARACTERIZE THE PURCHASE FROM SCE&G IN ITS REPORT TO THE RUS?

A In July 2004, NCEMC prepared a report entitled *Alternative Evaluation Study* for the RUS. This report characterized the 250 MW and 100 MW SCE&G purchase contracts as follows:

> The SCE&G Intermediate Resource includes 250 MW of system firm intermediate capacity from January 1, 2004 through December

31, 2012. This resource is used to serve both the load requirements of Participating Members and obligations of Independent Members. Also supplied by SCE&G is a 100 MW system firm peaking purchase from January 1, 2004 through December 31, 2005. [NCMEC, *Alternative Evaluation Study*, 10]

Q IF A CONTRACT IS FIRM, DOESN'T IT USUALLY HAVE PENALTIES FOR NON-PERFORMANCE?

A Yes, usually a firm contract has penalties which are assessed on a party for not performing on an executed contract. These penalties reimburse the damaged party (in this case, the buyer) for purchases it may have had to make in the open market to replace the contracted amounts of electricity that were not delivered. These penalties, however, can take several forms. "liquidated damages" ("LD") are one of the more common types of penalty assessed in firm contracts.

Q WHAT DOES THE NCEMC RFP SAY ABOUT PENALTIES?

A. The RFP sent to the market by NCEMC, which was ultimately awarded to the Company, is explicit in noting that firm contracts should include "an appropriate penalty for failure to deliver," and that "liquidated damages will be required for all proposals." [Response to Columbia Energy RFI 2-3(b); North Carolina Electric Membership Corporation RFP No. 1008, p. 10.]

Q SHOULD THE COMMISSION EXCLUDE THE RECOVERY OF THE REMAINING 42 PERCENT OF JASPER FROM RETAIL RATES SINCE ALL

OF THE PUBLICLY AVAILABLE SOURCES OF INFORMATION INDICATE THAT THIS NCEMC CONTRACT IS FIRM?

A Yes, the Commission should not allow the Company to recover the costs of the remaining portion of the Jasper investment in retail rates since, as the Company represents, the additional capacity was developed to initially support a system-sale to NCEMC. Since the asset used to support this sale is not used and useful for South Carolina customers, the costs of the additional capacity, and the revenues associated with the NCEMC contracts supporting this capacity, should be removed for retail ratemaking purposes.

Q GIVEN THE COMPANY'S REPRESENTATION OF THE CONTRACT, WILL OUT-OF-STATE CUSTOMERS GET ANY ADVANTAGES SUPPORTED BY SOUTH CAROLINA RATEPAYERS?

A Yes. The Company indicates that its sale is a system sale and offers North Carolina customers a number of important benefits that potentially include: (1) fuel mix diversity; (2) pricing flexibility; and (3) reliability.

Q HOW WILL NCEMC CUSTOMERS BENEFIT FROM THE FUEL DIVERSITY SUPPORTED BY SOUTH CAROLINA RATEPAYERS?

A While the Company has not allowed Columbia Energy to review the contracts, it would appear from the discovery responses provided by the Company, as well as the NCEMC RFP, that was ultimately awarded to the Company, that the sale to North Carolina is a system sale. [Response to Columbia Energy 2-4(a).] This system sale to North Carolina is supported by the entire diversified SCE&G generating fuel mix (i.e., its system), which in turn is

supported by South Carolina ratepayers. This generating mix includes a number of low cost hydro and solid-fuel assets that can give the Company several advantages in offering longer term off-system sales bids. A break out of SCE&G's generating fuel mix is provided in Exhibit DED-12.

Q WILL NCEMC CUSTOMERS GET SOME KIND OF PRICING ADVANTAGES AND FLEXIBILITY AS A RESULT OF THIS DIVERSITY?

A Yes, according to the Company, the NCEMC contract is based upon a number of pricing mechanisms, the nature of which are not clear since Columbia has not had the opportunity to review the contracts. [Response to Columbia Energy RFP 2-4(c).] In the RFP which was ultimately awarded to the Company, NCEMC requested a "creative pricing mechanism to reduce risk" and specifically references indexing prices to a "variety of fuel indices rather than one fuel like natural gas." [Response to Columbia Energy 2-3(b), North Carolina Electric Membership Corporation RFP No. 1008, p. 11.] Since this is a system sale, there is a probability that contract prices offered to NCEMC will in some way be able to take advantage of the diverse SCE&G fuel mix, and not be based strictly on the natural gas-based, Jasper-specific costs.

Q CAN NCEMC MAKE A PROFIT OFF THE ELECTRICITY IT PURCHASES FROM SCE&G?

A It would appear that way. NCEMC notes in its solicitation that it will heavily favor bids that do not require restrictions on re-sales of capacity. [Response to Columbia Energy 2-3(b), North Carolina Electric Membership Corporation RFP No. 1008, p. 11.] The Company, on the other hand, is

restricted from reselling any recalled power under the contract. [Response to Columbia Energy RFI 2-3(g).]

Q IF THE NCEMC CONTRACT RATES WERE LOOSELY BASED UPON SYSTEM COSTS, WOULD NCEMC GET A BENEFIT RELATIVE TO A CONTRACT BEING BASED ON THE COSTS OF JASPER ALONE?

A Yes since, as the Company notes:

> The average operating cost of energy from Jasper will likely be higher than the SCE&G system average operating cost of energy since the average operating cost of the system includes significant amounts of energy from nuclear, coal, and hydro units. [Response to Columbia Energy RFI 2-4(f).

Q WILL NCEMC GET A RELIABILITY BENEFIT SUPPORTED BY SOUTH CAROLINA RATEPAYERS?

A Yes, NCEMC will get a reliability benefit by having a system-based sale as opposed to one based on Jasper alone. The Company has noted that:

> ...a system-based sale allows the seller to optimize dispatch of its fleet of generation resources which is substantially more efficient than running a single unit alone to serve a specific alone to serve a specific load. In addition, a system-based sale, as opposed to a sale made relying on a specific unit, affords the buyer a greater degree of reliability. [Response to Columbia Energy 2-4(a).]

Q GIVEN THE SIGINFICANT BENEFITS NCEMC IS GETTING ON THIS SYSTEM-SALE CONTRACT, IS IT APPROPRIATE REGULATORY POLICY

FOR THE COMMISSION TO ALSO ALLOW THE REMAINING EXCESS 42 PERCENT OF JASPER INTO SOUTH CAROLINA RATES?

A No. The development of the additional capacity at Jasper allowed the Company to make the off-system sale with NCEMC, who in turn, is getting considerable benefits from the entire generating mix of SCE&G. It is simply not equitable for South Carolina ratepayers, to in turn, support any additional costs associated with the additional capacity created by Jasper for which they get little to no economic benefit today.

SECTION VII: THE COMPANY SHOULD BE DENIED RATE RECOVERY SINCE IT DID NOT SOLICIT THE MARKET PRIOR TO THE DEVELOPMENT OF THE JASPER GENERATION FACILITY

Q DID THE COMPANY TEST THE MARKET TO MAKE SURE ITS DECISION ASSOCIATED WITH JASPER WAS APPROPRIATE AND THE LEAST-COST RESOURCE FOR RATEPAYERS?

A No, the Company did not conduct an RFP or competitive bidding process to determine if the Jasper Generation Facility was the lowest cost resource available in the market. [Response to Columbia Energy RFI 2-20(m).] There is no excuse for not having conducted a competitive bidding process prior to constructing Jasper. As I will discuss in a later section of my testimony, there is a considerable amount of merchant generation availability in South Carolina, VACAR, and the southeast. The Company could have tested its project to these market resources to ensure that its ratepayers were getting the least-cost option available in the market.

Q WHY DID THE COMPANY NOT PERFORM AN RFP FOR THIS CAPACITY NEED?

A According to Order No. 2002-19, the Company did not perform an RFP because one had been conducted several years prior during the Urquhart Repowering Project investigation. [Order No. 2002-19.] However, this analysis suffers from two problems. First, it was conducted in a period prior to the rapid development of wholesale markets in the southeast (in the 1999 time period). Second, the process followed by the Company may be inconsistent with the competitive bidding practices required by regulators in states that have competitive bidding rules.

Q DID ANY PARTIES TO THE CON PROCEEDING QUESTION THE COMPANY'S FAILURE TO TEST THE MARKET THROUGH AN RFP PROCESS?

A Yes, the Office of Consumer Advocate ("CA") did question the Company's decision making process. In fact, in the CON proceeding, the CA filed a Motion asserting that if the Commission issued a certificate in the proceeding, that it should include a condition that the Company must evaluate the purchase power option before its requested rate relief. The Commission, however, ultimately denied the CA's position.

Q DID THE COMMISSION LEAVE THE COMPETITITVE BIDDING QUESTION OPEN FOR THIS PROCEEDING?

A Yes. The Commission specifically left this issue open for future consideration. In denying the CA's motion, the Commission noted that:

> ...should SCE&G file a rate application including this plant in rate base, the Consumer Advocate will have an opportunity to address this issue during that rate proceeding. [Order No. 2002-19 at 15.]

This rate proceeding, therefore, is ripe for consideration of the Company's failure to conduct a competitive bidding process, notwithstanding the allowance of 58 percent of the facility's cost into rates via CWIP. This proceeding is associated with, among other things, allowing the remaining 42 percent of the plant into rates (i.e., a "rate proceeding"). Therefore, the competitive bidding issue associated with this additional capacity should be considered.

Q DO YOU THINK THE COMPANY'S FAILURE TO SOLICIT A COMPETITIVE BID SUPPORTS YOUR POSITION THAT THE REMAINING 42 PERCENT OF JASPER SHOULD NOT BE RECOVERED IN RETAIL RATES?

A Yes. The Company should have been required to conduct an RFP process to ensure that it could not find a lower cost, more flexible option in the market.

SECTION VIII: THE COMMISSION CAN AVOID UNCERTAINTIES ASSOCIATED WITH FUTURE UTILITY GENERATION INVESTMENT DECISIONS BY OPENING A COMPETITIVE BIDDING RULEMAKING

Q WHAT IS COMPETITIVE BIDDING?

A Competitive bidding is a type of search process developed to find the lowest cost good or service. Many firms in competitive industries go through a

competitive bidding process in order to find the least cost opportunities available in the market. This type of search process is common in situations where it is difficult to obtain complete information about a particular good or service.

Q WHY SHOULD A COMPETITIVE BIDDING PROCESS BE ADOPTED FOR A REGULATED INDUSTRY?

A Often times, regulators have a hard time determining the true, least-cost method of providing utility services. Utilities, on the other hand, often have relatively complete information about their costs structures and ability to serve customers. This leads to a situation where one party to a transaction (the regulator) has less information than the other party (the regulated company) about the cost of providing service. Competitive bidding has arisen in utility regulation as a means to balance this "asymmetry" in information between regulators and their regulated companies. By submitting resource acquisition decisions to the market, regulators can better insure they are getting the best deal for their ratepayers.

Q WHAT BENEFITS WOULD A UTILITY GET BY BUILDING TOO MUCH CAPACITY?

A Regulated utilities, like SCE&G, are allowed the opportunity to earn a fair rate of return on their investment. This investment is represented by a utility's rate base, or the investment in plant that a utility has made to serve its customers. The larger this "base," the larger the total return that a Company will earn. Thus, while regulated utilities may not get any direct profits from sale of electricity in these wholesale markets, they do continue to earn a return on their

investment, which can become inflated or "gold plated" if not checked with some kind of market discipline. The regulated utility gets the further benefit of being insulated from market risk because the costs of the facility are recovered in a regulated rate base. This is an advantage that most competitive providers of electricity (i.e., "merchant generators") do not have.

Q HOW DOES THIS RELATE TO THE CURRENT PROCEEDING?

A SCE&G's proposal to include the Jasper Generating Facility into rates is an example of this type of gold plating that gives the Company the ability to unfairly compete in wholesale markets. The Company can "super-size" a generating facility, like Jasper, that is not used and useful for regulated South Carolina customers, and use it to serve competitive wholesale markets, like the NCEMC contract, instead of its ratepayers. The Company is insulated from competitive pressures because the cost of its plant, unlike other merchants, is being recovered from a regulated sales base. This is a problem because it burdens retail ratepayers as well as competitors in wholesale markets.

Q HOW DOES COMPETITIVE BIDDING FIX THIS PROBLEM?

A The competitive market provides a check on the type and costs of the investments made by regulated utilities. By offering a potential resource acquisition to the market, a regulator can review all the various options and prices that compete with the utility self-build option. If the utility proposal is lower in price, or more advantageous in other characteristics that can be included (i.e., resource flexibility, reliability, fuel diversity, etc.), then a regulator has some kind

of assurance that it appropriately queried all other types of options possibly available to serve customers.

Q WHY IS THIS A BETTER APPROACH THAN THE DISALLOWANCE PROCESS YOU DISCUSSED EARLIER IN YOUR TESTIMONY?

A A competitive bidding process is a more "proactive" rather than "reactive" regulatory approach. Competitive bidding is proactive in the sense that regulators can ensure, up front, any costs incurred by a utility to serve its customers have been tested by the market. Disallowances are admittedly reactive, and require a regulatory commission to penalize a regulated company after an investment has been made.

Q IN GENERAL, HOW DOES A COMPETITIVE BIDDING PROCESS WORK?

A In the electric power industry, the first step would be for a utility to submit a need determination to its regulator, as well as its proposed method for meeting that need, such as building a new generating facility, or going straight to the market for a purchased power agreement (or both). The utility then develops a solicitation based upon this need. This solicitation should clearly outline the type and unique characteristics of the resource need, the non-price terms associated with the bid evaluation, and the characteristics and costs of the utility self-build option upon which, the bid will be evaluated (if any). The solicitation, or "Request for Proposals" ("RFP") is then submitted to a wide range of potential bidders, who in turn, will be allowed to submit sealed offers if they meet the minimum credit and reliability criteria outlined in the RFP. The submitted bids are then reviewed

by an objective reviewing party that selects the least cost, most reliable offer submitted by the market. If the utility option is the lowest of those submitted, the utility is then directed to initiate construction and development of a new generation facility.

Q IS COMPETITIVE BIDDING A NEW IDEA IN STATE UTILITY REGULATION?

A No, competitive bidding has existed for a number of years and has been employed by several states. Its most common use in the electric industry in the late 1970s and early 1980s was to ease the burden of administratively determining avoided costs when dealing with qualifying facilities ("QFs"). One of the first rules was developed in 1984 so Central Maine Power Company would only have to purchase QF power that was appropriately valued.

Q HAVE ANY STATES IN THE SOUTHEAST ADOPTED COMPETITIVE BIDDING RULES?

A Yes. Several southeastern states have adopted rules or policies on competitive bidding. A summary of these rules in the Southeast are provided in Exhibit DED-13. Currently, Florida, Georgia, and Louisiana have competitive bidding rules. Alabama has a competitive bidding policy. Arkansas has an open proceeding on competitive bidding.

Q SCE&G HAS BEEN CRITICAL OF COMPETITIVE BIDDING IN THE PAST. WHAT IS YOUR UNDERSTANDING OF THEIR OPPOSITION OF COMPETITIVE BIDDING?

A Several parties in the CON proceeding raised questions about the Company's decision to build the Jasper Generating Facility as an 875 MW plant. The CA's Office suggested that the Company should have entered into a competitive bidding process to ensure that it was securing the most flexible, least cost option. The Company argued that its self-build option was better than securing resources from competitive markets for the following reasons:

- It provides significantly more flexibility in scheduling and does not put the company at risk for penalties.
- It is more reliable since the Company will maintain the plant and the availability of capacity will not be subject to the time required and uncertainty inherent in enforcing purchased power agreements when customers' energy needs are immediate.
- It should be more economical in the long run, since purchased power costs tend to rise with inflation, while the cost of carrying a self-owned plant will decrease over time as a result of depreciation.
- There are no economic benefits to the community when generation is built [by competitive providers]. [Docket No. 2001-420-E, Order No. 2002-19: 7.]

Q DO YOU THINK THE COMPANY'S POSITION HAS ANY MERIT?

A No. Several states around the U.S., including those in the Southeast, are moving to competitive bidding processes to secure new supply-side resources. Competitive bidding is not a new or novel regulatory concept. Numerous investor-owned utilities have conducted RFP processes over the past 20 years.

Further, municipal utilities and rural cooperatives have purchased, and continue to purchase, considerable amounts of energy through competitive bidding.

Q ARE THE COMPANY'S ACTIONS AS A COMPETITIVE PROVIDER TO NCEMC CONTRADICTORY TO THEIR POSITIONS ON COMPETITIVE BIDDING?

A Yes. The RFP that was issued by NCEMC, and ultimately awarded to the Company, detailed a number of specific provisions to remedy many of the purported shortcomings of competitive bidding identified by the Company. NCEMC required most of all of the issues raised by the Company to be addressed, and noted that offers would not be accepted from parties that could not meet a number of the more important conditions. For instance, the RFP was explicit on such issues as:

- Requiring firm resources.
- Providing pricing flexibility.
- Excluding "take-or-pay" provisions and restrictions on the re-sell of power.
- Providing mandatory scheduling flexibility.

As a wholesale market competitor, SCE&G was able to meet all these terms and conditions and win the competitive bid. However, the Company argues before this Commission that wholesale markets, and similarly situated competitors, cannot meet these same terms. The argument is inconsistent with the Company's practices as a wholesale competitor, and in the case of the decision to build Jasper, unsupported since the Company did not conduct an RFP process.

Q DO COMPETITIVE PROVIDERS CREATE ANY ECONOMIC BENEFITS IN THE COMMUNITIES IN WHICH THEY LOCATE?

A Yes. Competitive, or merchant, power providers create significant economic benefits in the communities in which they locate. As a general matter, most economic development benefits associated with the construction and operation of electric power generation facilities are a function of the technology and total investment dollars associated with a particular project. With the exception of a few differential tax benefits, the overall economic benefits (i.e., output, employment, wages) associated with power generation projects are not usually a function of the type of provider developing the facility (i.e., merchant versus utility). Thus, the Company's position that in-state merchant facilities do not provide local economic benefits is completely without merit. There is, however, one additional benefit that is created by a competitive bidding process that does not occur in a traditional environment in which utilities are always presumed to be the developer of new generation resources. These benefits include the cost savings that accrue to ratepayers. Competitive bidding forces the attainment of competitive opportunities, which results in increased efficiencies and savings, even if the utility self-build option is selected.

Q WHAT BENEFITS HAS CALPINE CREATED FOR THE SOUTH CAROLINA COMMUNITIES IN WHICH IT IS LOCATED?

A Calpine has developed two facilities in South Carolina. One of these facilities ("Columbia Energy") is located in Calhoun County. The second is the Broad River facility located in Cherokee County. The Governor, industry and

state and local officials applauded the significant investments in these areas. The projects create a number of one-time and ongoing economic benefits for South Carolina – both projects represent close to $700 million in direct capital investments. In 2003, Calpine paid some $2 million in property taxes and $3 million in wages and benefits. The Company has also provided a number of charitable contributions to the local communities, in addition to numerous volunteer hours to support local organizations.

SECTION IX: THERE IS A CONSIDERABLE AMOUNT OF GENERATION AVAILABLE IN THE SOUTHEAST TO SUPPORT A COMPETITIVE BIDDING PROCESS IN SOUTH CAROLINA

Q IS THERE A CONSIDERABLE AMOUNT OF MERCHANT CAPACITY DEVELOPMENT IN SOUTHEAST THAT THE COMMISSION COULD RELY UPON FOR INITIATING A COMPETITIVE BIDDING PROCESS?

A Yes. It is a well-recognized fact that SERC is one of the most highly developed regions for merchant generation in the U.S. Exhibit DED-14 shows this development with a map of existing merchant facilities in the SERC region. This merchant development is further summarized in tabular form in Exhibit DED-15. Currently, there are 56 non-peaking merchant facilities with 30,537 MW of generation capacity in the SERC region. In addition, there is 13,259 MW of capacity that is under construction or planned for the next 5 years.

Q IS THIS DEVELOPMENT EVEN THROUGHOUT SERC?

A No, as shown in Exhibit DED-15, there are four sub-regions in the SERC: Entergy, Southern Companies, the Tennessee Valley Authority ("TVA"), and the

Virginia-Carolinas Reliability Region ("VACAR"). Currently, the Entergy sub-region has 12,934 MWs of non-peaking merchant generation capacity, Southern Companies subregion has 7,548 MW, TVA subregion has 4,882 MW, and VACAR subregion has 5,173.

Q ARE THERE ANY MERCHANT FACILITIES THAT ARE CURRENTLY UNDER CONSTRUCTION?

A Yes. In addition to existing merchant generation, there are a number of merchant generators that are located in the region, currently under construction, and scheduled to come on-line prior to 2010. Exhibit DED-16 provides a map of these facilities throughout the southeast. Currently, there are 6 facilities under construction in the region, amounting to 4,542 MW of additional potential capacity.

Q WHAT ABOUT FACILITIES UNDER DEVELOPMENT?

A There are also a number of merchant facilities that are considered to be "under development." A number of these facilities are speculative at this time, and given current market conditions, are probably not likely to get built without some kind of firm contract for the plant output. Nevertheless, as shown in Exhibit DED-17, there are 12 facilities under development in the southeast, amounting to approximately 8,717 MW of capacity.

Q HOW MUCH MERCHANT DEVELOPMENT HAS TAKEN PLACE IN VACAR?

A Currently, there are 16 merchant plants with a total of 5,173 MW of generating capacity operating in the VACAR region. There is one plant currently

under construction in the region, accounting for 578 MW, and three plants totaling 1,930 MW that have been proposed. A map of the VACAR development has been provided in Exhibit DED-18.

Q SO DO YOU SEE GENERATION MARKETS IN THE SOUTHEAST AS BEING LIMITED?

A No. All told, there is considerable development, and potential development, in this market. Exhibit DED-19 combines all of the types of facilities discussed earlier into one map.

Q WHAT DOES ALL THIS MERCHANT GENERATION AVAILABILITY MEAN FOR YOUR COMPETITIVE BIDDING PROPOSAL?

A There is a considerable amount of capacity throughout the southeast that would be interested in serving South Carolina's generating needs. In fact, some of this development is located in South Carolina and has already created a number of considerable benefits for the state in terms of the increased local spending; increased employment, and an increased property and sales tax base. The Commission has the opportunity to increase these benefits to ratepayers by allowing these South Carolina plants to compete for the Company's future resource requirements. Competitive bidding will ensure that the lowest cost resource is used to serve ratepayer needs.

Q DOES ALL THIS MERCHANT GENERATION AVAILABILITY HAVE ANY IMPLICATIONS REGARDING THE COMPANY'S EXCESS CAPACITY CREATED BY JASPER?

A Yes. There is, and has been, considerable merchant development in the region. The Company's resource requirements could have been met by a more flexible market-based resource than the construction of a regulated generating facility. The lack of market opportunities should not be considered as a legitimate reason for not having conducted a competitive bid for the additional resource requirements that were identified in the CON proceeding. Had the Company needed additional requirements, it could have entered into a second contract, much like the additional 100 MW deal it executed with NCEMC to displace the growing amount of excess capacity projected to be created by Jasper.

SECTION X: RECOMMENDATIONS

Q WOULD YOU PLEASE SUMMARIZE YOUR RECOMMENDATIONS?

A I recommend that the Commission remove all of the costs of the additional capacity (42 percent) of Jasper from retail rates, along with the NCEMC contract revenues. The excess capacity associated with the Jasper Generating Facility is not needed at the current time to serve native load. If allowed into rates, this excess capacity will allow the Company to participate in competitive wholesale markets with the downside risks being borne by its captive retail ratepayers. In the past, the Commission has disallowed unused portions of generating facilities into rates. It should exercise this precedent in the current proceeding. Further, I recommend that the Commission initiate a rulemaking proceeding on competitive bidding. Requiring utilities to conduct a competitive bidding prior to acquiring

new resources will ensure that they have procured the most cost effective, flexible resource available in the market.

Q DOES THIS CONCLUDE YOUR TESTIMONY FILED ON OCTOBER 11, 2004?

A Yes.